



Statement
of
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on behalf of
Tax Executives Institute, Inc.
on
Customer Service Needs of Taxpayers
before the
IRS Oversight Board
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Good afternoon. I am Dave Bernard, Vice President - Taxes, Kimberly-Clark Corporation. I also serve as Senior Vice-President of the Tax Executives Institute, the preeminent association of business tax professionals and am pleased to participate in today's hearing of the IRS Oversight Board.

BACKGROUND

Tax Executives Institute was established in 1944 to serve the professional needs of in-house tax practitioners. Today, the Institute has 53 chapters in the United States, Canada, Europe, and Asia. Our 5,800 members are accountants, attorneys, and other business professionals who work for 2,800 of the leading global companies; they are responsible for conducting the tax affairs of their companies and ensuring their compliance with the tax laws. TEI represents the business community as a whole, and our members deal with the tax code in all its complexity, as well as with the Internal Revenue Service, on almost a daily basis. TEI is dedicated to the development and effective implementation of sound tax policy, to promoting the uniform and equitable enforcement of the tax

laws, and to reducing the cost and burden of administration and compliance to the benefit of taxpayers and government alike.

The companies that employ TEI's members have almost without exception been assigned to the IRS's Large and Mid-Size Business (LMSB) Division. The largest 1,600 taxpayers within LMSB are subject to ongoing audits as part of the Coordinated Industry Cases (CIC) program. The Institute's testimony is largely based upon our experience with this segment of IRS operations. We are pleased to offer our views on the customer service needs of taxpayers within the IRS and, more particularly, LMSB.

Defining Good IRS Customer Service

A. *Currency.* In its notice on this hearing, the IRS Oversight Board notes:

The IRS has shown considerable progress providing customer service during the past five years. Service levels have improved to the point where it is no longer axiomatic that service needs to be improved. The IRS may have arrived at the point where service levels are good enough, or close enough to the desired level, so that the IRS should strive to achieve these levels at less cost, or explore other dimensions of customer service that heretofore have not been analyzed in detail.

One measure of good customer service is the reduction of audit cycle time to improve audits and audit coverage. Since its inception in 1999 the IRS's Large and Mid-Size Business Division has striven to offer new and innovative services to taxpayers in an effort to achieve more current audits.

The key to achieving currency is cooperation with taxpayers. More than two years ago, TEI joined with LMSB to produce the Joint Audit Planning Process, whose goals are two-fold: (i) to establish accountability in executing a jointly developed audit plan, and (ii) to develop an issue-focused plan to, if you will, separate the wheat from the chaff and thereby increase audit efficiency. The process emphasizes that the keys to a successful audit are communication, trust, and openness.

The Division has also sought other ways to increase currency, offering taxpayers a variety of alternatives — such as Limited Issue Focused Examination (LIFE), Pre-Filing Agreements (PFAs), and Fast Track Settlement — to resolving disputes. LIFE in particular — with its focus on the resolution of material issues — holds great promise in reducing disputes and decreasing cycle time. Most recently, in 2005, 17 taxpayers — including many TEI members — enrolled in a pilot program, the Compliance Assurance Process (CAP), which employs real-time issue resolution and

requires the IRS to work with the taxpayer to resolve issues prior to the filing of a tax return. The IRS has decided to continue the program in respect of 2006.

These processes all have one thing in common — the desire to settle cases at the lowest possible level. LMSB's efforts in this regard have begun to have some effect. According to one source, in fiscal year 2004, the IRS closed 1,500 more industry cases (ICs) than in FY 2003. The months-in-process declined by two and one-half months with no decrease in quality. There was also a four-month decline in months-in-process in the CIC group and 640 more tax returns were audited and closed. The currency rate increased from 37 percent to 47 percent in 2004 and was at 62 percent as of August 31, 2005. Closures for 2005 will likely exceed 2004 totals.¹

There is anecdotal evidence that the use of these processes may vary from region to region and industry to industry. In addition, the emphasis on becoming current at the Examination level may be increasing the number of issues sent to Appeals.

TEI urges the Oversight Board to encourage the IRS to make these issue resolution programs more widely available. Currency benefits both the government and taxpayers by conserving taxpayer resources and permitting the IRS to focus its resources on areas of noncompliance.

B. *E-Filing Mandate.* In January 2005, the IRS issued temporary and proposed regulations requiring certain large corporations to electronically file their 2005 income tax return.² This mandate, issued without proper consultation with affected taxpayers, will impose significant burdens on the business community without any assurance that the IRS will have adequate systems, procedures, and personnel in place to receive and process the data and capabilities to effectively analyze that data to fulfill its audit and compliance responsibilities. The Institute believes the mandate is an example of how *not* to deliver good customer service.

¹ See Thomas W. Wilson, Jr., *Architect of IRS Currency Initiative Advises LMSB Taxpayers Prepare For Impact of CAP Initiative, Form 1120 E-Filing, Schedule M-3, Section 199*, BNA Daily Tax Rep. No. 2, J-1 (Jan. 4, 1006).

² The temporary and proposed regulations mandate the electronic filing of large corporate tax returns for taxable years ending on or after December 31, 2005. For tax year 2005 returns that are due in 2006, the regulations require that corporations with total assets of \$50 million or more file their Forms 1120 and 1120S electronically. The electronic filing requirement applies to entities that file at least 250 returns, including income tax, excise tax, information, and employment tax returns during a calendar year. The proposed regulations were accompanied by temporary regulations, which became effective upon their publication in the *Federal Register* (February 12, 2005).

Let there be no misunderstanding — TEI supports the goal of increasing the IRS's use of technology including its ability to effectively process e-filed returns. Further, we agree that a properly designed and implemented e-filing process will advance key IRS objectives, namely, providing the IRS with accurate and timely return information, reducing audit cycle time, and achieving currency in those audits. Since the regulations were issued, TEI and other interested parties have worked with the IRS to help make the e-filing mandate a reality. The Institute has met several times with the IRS, and our members and staff have participated in an IRS task group (styled the "IRS-TEI Forms and Attachments Task Group"). This group has held several day-long sessions and numerous conference calls to review every form and schedule a corporate taxpayer may file in an attempt to determine which forms could be filed in XML format and which could be filed in other formats (such as PDF files and on paper). Meetings have also been held with the major software vendors (CorpTax, InSource, and Vertex) in an effort to identify challenges and work toward acceptable solutions.

In spite of the tremendous efforts of IRS, taxpayers, and the software vendors, significant challenges remain — issues that may not be solvable by the time the returns are due to be filed later this year. TEI believes that the IRS's e-filing mandate imposes unnecessary costs on taxpayers and may threaten the orderly processing of returns for the 2006 filing season.

What could the IRS have done differently in respect of e-filing to improve customer service?

First, the IRS should have reached out to the affected taxpayers *before* the mandate was issued. The largely unilateral process employed by the IRS stands in marked contrast to the collaborative, customer-service approach the agency has productively used in other areas. For example, the processes affecting currency noted above were developed through joint efforts of both the agency and taxpayers. Or consider another recent IRS project, relating to the Schedule M-3 on which a taxpayer reports book-tax differences. With the Schedule M-3, the IRS and Treasury actively sought taxpayer input more than a year in advance and worked to address concerns *before* a draft of the schedule was issued. And, even after the form was collaboratively developed, the IRS afforded affected taxpayers time to recommend changes and to implement the mandate.

Second, the IRS should have provided for a phased-in implementation of the mandate, permitting taxpayers and software vendors adequate time to develop and test the software packages. One major challenge of the proposal is that many taxpayers use different types of software; a company may, for example, use CorpTax to prepare its domestic schedules and forms and InSource to prepare its international forms. One year after the issuance of the mandate, there is still no software that would permit data from multiple programs to be aggregated in one XML file, as required by the regulations. In other words, the IRS has gotten ahead of the market in respect of this

initiative. In its recent annual report, this Board recognized that the goal of having 80 percent of returns electronically filed by 2007 is ambitious, but impossible to meet. The IRS should likewise admit that a more measured approach by the agency in respect of corporate returns is warranted. Phasing in the mandate would allow for the development of an aggregation program and permit taxpayers to adequately test the new systems.

Third, the IRS should have permitted taxpayers and software vendors more time to test the new system. Prototypes of the new software to be used to facilitate e-filing were only issued in January 2006 — and one major vendor's package is not expected until March. While historically program and version updates are typically released in December, corporate taxpayers are understandably concerned about integrating the new programs into their existing data collection. Given the wholesale changes that have to be incorporated in the new software, taxpayers will be extremely pressed to install, test, and debug the software before their returns must be filed. Further, it is not clear what tools the vendors will provide to allow taxpayers to review data before actual submission. The rushed implementation of this mandate increases the risk of duplicated effort and waste of limited resources.

Finally, prompt, meaningful guidance on securing hardship waivers from the e-filing mandate should have been a higher priority within the IRS. Initially taxpayers were promised that the criteria for obtaining a waiver would be issued by September 1st. Other priorities (including the need to address tax administration issues spawned by Hurricanes Katrina, Rita, and Wilma) delayed the guidance, which was not issued until November 10th. Although the delay is understandable, it deprived taxpayers of the time and detail needed to determine whether they will come within the mandate and to establish a plan for compliance. Of greater significance is that, even after taking additional time to develop the guidance, the IRS's notice provides taxpayers with little assistance in determining what might or might not qualify a taxpayer for relief. For example, the IRS has indicated on several occasions that companies undergoing mergers and acquisitions may be candidates for relief, but nothing in the notice addresses this issue. Examples of circumstances in which a waiver will be issued are sorely needed (*e.g.*, whether a taxpayer's attempted e-filed return constitutes the "return" for federal income tax purposes; whether a "protective" hardcopy return will protect taxpayers' timely completed but un-filed elections, etc.).

The IRS has also shown little sympathy for the financial burden the e-filing mandate would impose on taxpayers, informally suggesting that cost would rarely, if ever, be a basis for a hardship waiver. This is especially disappointing because section 6011(e)(2)(B) of the Internal Revenue Code requires the IRS to take into account the ability of taxpayers to comply at reasonable cost with such a mandate. In TEI's view, the costs to taxpayers of complying with the mandate and the benefits to the government should be considered and made public.

In sum, the “ready-fire-aim” philosophy that manifested itself here has acted as a barrier to good customer service.

C. *Independence of Appeals.* In comments filed on January 17, 2006, TEI expressed concern about the effect of Announcement 2005-80 on the independence of Appeals. (The announcement sets out concession terms for 21 transactions for which the IRS has determined the accuracy-related penalty to be applicable.) In TEI’s view, Announcement 2005-80 threatens to fundamentally change the balance between Examination, Appeals, and taxpayers and to deprive taxpayers of a right conferred by Congress. By asserting that “eligible persons who forgo resolving eligible transactions under this settlement initiative...should not expect to receive a better offer in Appeals than that offered under this settlement initiative,” the IRS seemingly usurps the authority of Appeals to assess (and the right of taxpayers to have Appeals assess) the merits of cases. *Let there be no mistake:* This is not about tax shelters, but about the fundamental nature of Appeals.

The flaw in the Announcement is illustrated by those transactions involving valuation disputes.³ How can the IRS ensure the independence of Appeals (as mandated by IRS Restructuring and Reform Act of 1998) while intimating that valuation disputes – which are inherently factual – can be resolved in a formulary, cookie-cutter manner? We submit it cannot.

TEI recognizes that a delicate balance must be struck between enforcement efforts and customer service. Because Congress has unambiguously spoken on the issue of Appeals independence, however, the IRS must look for other ways to alter that balance. The Board should encourage the IRS to reaffirm and formalize its commitment to ensuring the independence of Appeals consistent with the statutory directive.

D. *Service Center Issues.* One measure of good customer service is the ability to respond to taxpayers’ needs. In many cases, taxpayers must rely upon IRS service centers or “campuses” to supply needed documentation for foreign and local governments.

For example, many companies process tax returns for non-U.S. citizens who are transferred from overseas. These employees may have spouses and children who are claimed as dependents on the individual’s U.S. tax return. Most dependents do not qualify for Social Security numbers, but rather are required to apply for individual identification numbers (ITINs). The companies often take on the responsibility of filing the Form W-7 (*Application for IRS Individual Identification Number*).

³ See Announcement 2005-80, Section 3, transaction nos. 17 (trust arrangements seeking to qualify for exemption under IRC section 419); 18 (distributions from charitable remainder trusts), 19 (charitable contributions and conservation easements), and 20 (charitable contributions of patents and other intellectual property).

The Philadelphia Service Center is responsible for processing these forms, but properly filled out Forms W-7 are often rejected for no apparent reason. One TEI member company reports that rejections may run as high as 25 percent. The delay in receiving ITINs causes numerous problems for these employees; spouses are unable to obtain a driver's license, children may be delayed from enrolling in local schools, and the family may be unable to open a bank account. TEI cannot vouch for the accuracy of all the forms, but we do believe the Service Center can and should do more to identify the reasons (and remedies) for the rejections. A commitment to good customer service demands that the IRS better train its agents and provide more helpful information to affected taxpayers.

Our members also report significant problems at the Philadelphia Service Center in processing Forms 8802 (*Application for U.S. Residency Certification*), which are often required by companies or individuals to claim benefits under a tax treaty or to prove tax status for purposes of claiming a benefit such as a refund of VAT taxes. Delays in receiving these certifications can be costly for taxpayers and waste resources of both the taxpayer and the government.

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Tax Executives Institute commends the IRS Oversight Board for holding this public hearing. TEI looks forward to working with the Board and the IRS itself to improve tax administration.

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By:

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